

# **Finance and Administration Cabinet**

## **Office of Financial Management**

### **Investment Manual**



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I.  
**PURPOSE.**

The Finance and Administration Cabinet (FAC) Office of Financial Management (OFM) Investment Manual (Investment Manual) describes policies, restrictions and trading limits as approved and overseen by the State Investment Commission (SIC) for the OFM staff.

The Investment Manual is an internal reference source only and does not supplant or supersede state or federal statutes or regulations as well as applicable authoritative guidance. It is intended to assist personnel in understanding, interpreting, and applying authoritative pronouncements. On an as needed basis, OFM management will review and update the Investment Manual to ensure compliance with the Commonwealth statutes and regulations as well as SIC policy statements.

These policies are established in accordance with statutory authorities in KRS 12.270 and KRS 42.014, to establish the internal organization and functions of the Cabinet.

## II. **INVESTMENT AND STRUCTURE.**

### A. **Role of Investments.**

The function of the investment group is to invest state and agency funds between the time they are received and expended. By investing these funds into several well managed portfolios, the Commonwealth is able to reduce expenses from economies of scale and reduce risk through the advantages of diversification.

The investment objectives are in order as follows:

- Preservation of principal
- Adequate liquidity
- Maximize return

### B. **Structure.**

Pursuant to KRS 42.400, the OFM established in KRS 42.0201 shall be headed by an executive director responsible to the secretary of the FAC, and appointed by the secretary upon approval of the Governor in accordance with the provisions of KRS 12.050.

There are included in the OFM established in KRS 42.0201 the positions of deputy executive directors for investment and debt management, who shall be employed in the classified service as set forth in KRS Chapter 18A.

### C. **Statutory Authority.**

The SIC is charged with the oversight of the Commonwealth's investment programs pursuant to KRS 42.500, and KRS 42.505 which delegates the day-to-day management of the Commonwealth's investments to the OFM.

### III. **STATE INVESTMENT COMMISSION (SIC).**

The powers of the SIC, established by KRS 42.500, are as follows:

The SIC shall meet at least quarterly to review investment performance and conduct other business. This provision shall not prohibit the commission from meeting more frequently as the need arises.

Section 9 of KRS 42.500 states, the Commission shall have authority and may, if in its opinion the cash in the State Treasury is in excess of the amount required to meet current expenditures, invest any and all of the excess cash in:

Obligations and contracts for future delivery of obligations backed by the full faith and credit of the U.S. or a U.S. government agency, including but not limited to:

- U.S. Treasury; Export-Import Bank (EXIM) of the U.S.;
- Farmers Home Administration (FmHA);
- Government National Mortgage Corporation (GNMA);
- and Merchant Marine bonds;

Obligations of any corporation of the U.S. government or government-sponsored enterprise (GSE), including but not limited to:

- Federal Home Loan Mortgage Corporation (FHLMC);
- Federal Farm Credit Banks;
- Bank for Cooperatives;
- Federal Intermediate Credit Banks;
- and Federal Land Banks;
- Federal Home Loan Banks (FHLB);
- Federal National Mortgage Association (FNMA);
- and Tennessee Valley Authority (TVA) obligations;

Collateralized or uncollateralized certificates of deposit (CD), issued by banks rated in one (1) of the three (3) highest categories by a nationally recognized statistical rating organization (NRSRO) or other interest-bearing accounts in depository institutions chartered by this state or by the U.S., except for shares in mutual savings banks;

Bankers acceptances (BA) for banks rated in the highest short-term category by a NRSRO;

Commercial paper (CP) rated in the highest short-term category by a NRSRO;

Securities issued by a state or local government, or any instrumentality or agency thereof, in the U.S., and rated in one (1) of the three (3) highest long-term categories by a NRSRO;

U.S. denominated corporate, Yankee, and Eurodollar securities, excluding corporate stocks, issued by foreign and domestic issuers, including sovereign and supranational governments, rated in one (1) of the three (3) highest long-term categories by a NRSRO;

Asset-backed securities (ABS) rated in the highest category by a NRSRO; and

Shares of mutual funds, each of which shall have the following characteristics:

- The mutual fund shall be an open-end diversified investment company registered under Federal Investment Company Act of 1940, as amended;
- The management company of the investment company shall have been in operation for at least five (5) years;
- The mutual fund shall be rated in the highest category by a NRSRO;
- All of the securities in the mutual fund shall be eligible investments pursuant to this section.

The SIC shall promulgate administrative regulations for the investment and reinvestment of state funds in shares of mutual funds, and the regulations shall specify:

- The long and short term goals of any investment;
- The specification of moneys to be invested;
- The amount of funds which may be invested per instrument;
- The qualifications of instruments; and The acceptable maturity of investments.

Any investment in obligations and securities pursuant to Section 9 of this section shall satisfy this section if these obligations are subject to repurchase agreements (REPOs), provided that delivery of these obligations is taken either directly or through an authorized custodian.

The authority granted by this section to the SIC shall not extend to any funds that are specifically provided by law to be invested by some other officer or agency of the state government.

The authority granted by this section to the SIC shall only be exercised pursuant to the administrative regulations mandated by KRS 42.525.

The SIC is composed of the following:

1. Chair: Governor Vice Chair:
2. State Treasurer (Serve as chair in the absence of the Governor)
3. Secretary of the FAC
4. Two (2) persons appointed by the Governor
  - a. One (1) to be selected from a list of five (5) submitted to the Governor by the Kentucky Bankers Association, and
  - b. One (1) to be selected from a list of five (5) submitted to the Governor by the Independent Community Bankers Association.



## IV. **SECURITIES LENDING POLICY.**

### A. **Eligibility.**

The financial institution or its parent corporation must meet credit review by the staff of OFM plus approval by the SIC. The lending agent shall indemnify the Commonwealth from any borrower's failure to fulfill their obligations.

### B. **Collateralization / Reinvestment.**

Principal - The borrower of the Commonwealth's securities will be required to deliver to the Commonwealth a portfolio of eligible securities with a value of not less than 102% of the market value of the Commonwealth's securities lending portfolio. The borrower may, at its option, substitute cash equal to the value of the portfolio in lieu of eligible securities.

Agent - The lending agent may reinvest proceeds under the guidelines listed below.

Investment Manager - The lending agent shall immediately notify the OFM of any change in reinvestment management personnel.

### C. **Reinvestment Guidelines.**

Eligible securities must meet KRS 42.500 with the following additional limitations:

1. Floating rate securities are limited to a legal final of two (2) years.
2. Fixed rate securities are limited to a legal final of six (6) months.
3. Total effective duration of the portfolio should not exceed sixty (60) days. Maximum amount owned by name is \$15 million.
4. For ABS, maximum of \$15 million per shelf. The lending agent should be aware of securities being held by the Commonwealth in their own account and not increase a name in total over \$25 million.

### D. **Lending.**

Securities will only be lent to entities identified on the Corporate Credits Approved for Purchase list as approved for repurchase agreements at the most recent State Investment Commission meeting.

The maximum permitted amount lendable to any one entity, considering the aggregate lent from the OFM and KWCFC portfolios, is a market value of securities lent of \$300 million of which only \$100 million may be lent from KWCFC.

E. Reporting.

Daily reports should be available listing:

1. Securities lent, by borrower.
2. Collateral portfolio holdings.
3. Average maturity of loans versus average maturity of cash collateral investments.

Monthly reports:

1. Total income from securities lending.
2. The percentage of the portfolio on loan.
3. Average spread between the loan rate and cash collateral investment rate.

Immediate notification to the executive director of the OFM and also the primary contact for the Securities Lending Program, if the following occurs:

1. Any borrower of the Commonwealth's securities has a downgrade in credit rating or experiences a more severe credit event.
2. Any security owned in the Commonwealth's reinvest portfolio has a downgrade in credit rating or experiences a more severe credit event.

V.  
**TERM POOL INFORMATION STATEMENT.**

The State Investment Commission (“Commission”) is charged with the oversight of the Commonwealth's investment programs pursuant to KRS 42.500. The SIC is comprised of the Governor, the Treasurer, the secretary of the Finance and Administration Cabinet and two (2) gubernatorial appointees nominated by the Kentucky and Community Bankers Associations. The Commission delegates the day-to-day management of the Commonwealth's investments to the Office of Financial Management (“OFM”).

The Commonwealth's investments have been categorized into three (3) distinct classifications or "pools". There are at times special purpose pools created to invest funds dedicated to specific purposes.

1. The Short Term Pool consists primarily of General Fund cash balances and accounts, which pay their earnings to the General Fund.
2. The Limited Term Pool contains primarily certain state agency accounts, which do not pay their earnings to the General Fund.
3. The Intermediate Term Pool contains other state agency accounts, state held component unit and fiduciary fund accounts held for the benefit of others by the state.

The purpose of the investment pools collectively is to provide economies of scale, enhanced yield, ease of administration for both the user agencies and OFM, and increased accountability and control.

The Pool does not accept deposits from entities other than state agencies. Deposits are not accepted unless they are also recorded within the statewide accounting system.

The over-riding investment objectives of the Commonwealth's investment pools are:

- Preservation of principal.
- Maintenance of adequate liquidity to meet all cash needs.
- Maximization of return.

Furthermore, no assurance can be given that the Pool will achieve its investment objective or that any benefits described in this Information Statement will result from the investment of monies in the Pool by any Participant. However, the SIC and the OFM intend to make all reasonable efforts to attain the Pool's investment objectives.

## **Certain Risks of Investment in the Pool**

There are several risk factors that could hurt a Pool's performance, cause you to lose money, or cause a Pool's performance to trail that of other investments.

### **Interest Rate Risk**

When short-term interest rates fall, the Pool's yield is likely to fall. When interest rates rise, especially if the rise is sharp or unexpected, the Pool's share price could fall. During periods of unusually low interest rates, the Pool's yield may approach zero.

### **Credit Risk**

The issuer of an obligation owned by a Pool could fail to pay interest or principal in a timely manner. The credit quality of a Pool's holdings could change rapidly in certain markets, and the default or decline in credit quality of even a single holding could cause a Pool's share price to fall.

For money market instruments that rely on third-party credit guarantors, the same risks may apply if the financial condition of the guarantor deteriorates or the guarantor ceases to insure money market instruments. The value of the obligation may decline and it is possible that the guarantor will not honor the guarantee.

For U.S. government or agency securities not backed by the full faith and credit of the U.S. government, there is no guarantee that the government will intervene in the event of any loss or default.

Any type of credit backing or guarantee applies only to the obligations held by a Pool, not to shares of the Pool itself, and does not protect against any risk other than credit risk.

### **Counterparty Risk**

A financial institution or other counterparty with whom a Pool does business (such as trading or entering into REPOs), or that underwrites, distributes, or guarantees any investments or contracts that a Pool owns or is otherwise exposed to, may decline in financial health and become unable to honor its commitments. This could cause losses for a Pool or delay the return or delivery of collateral or other assets.

### **Financial Industry Risk**

Any market price movements, regulatory or technological changes, or economic conditions affecting banks or other financial institutions may have a significant impact on a Pool's performance.

### **Foreign Investment Risk**

To the extent that a Pool invests in U.S. obligations of foreign issuers that are denominated in U.S. dollars, it faces some of the risks of foreign investing, such as unfavorable political and legal developments, limited financial information, regulatory risk, and economic and financial instability.

### **Additional Cost Level Risk**

To the extent that a Pool invests in mutual funds rather than directly in money market instruments, the Pool's shareholders will effectively be paying two (2) or more levels of costs, which could reduce yields.

### **Liquidity Risk**

If the Pool faces an unusual volume of redemption orders, or if it is unable to sell Pool securities at the desired time or price, the Pool's share price could fall. In this case a negative income distribution could occur.

### **Obligation of US Government Agencies and Instrumentalities**

Participants should be aware that not all obligations issued by agencies and instrumentalities of the U.S. government are guaranteed by the full faith and credit of the U.S. government. The obligations of some agencies and instrumentalities of the U.S. government that may be purchased by the Pool from time to time are obligations only of the applicable agency or instrumentality and are not full faith and credit obligations of the U.S. The creditworthiness of such obligations relates only to the credit of the issuing agency or instrumentality. No assurance can be given that the agency or instrumentality will under all circumstances be able to obtain funds from the U.S. government or other sources to support all of its obligations.

***An investment in the Pool is not insured or guaranteed by the FDIC or any other government agency. Although the Pool seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Pool.***

## **Additional Policies**

### **Expenses**

The Pool is assessed an annualized charge, calculated daily and deducted monthly, of five (.0005) basis points (BPS) to defray operating expenses associated with its administration. Direct expenses can also be passed on to the Pool at the discretion of the SIC. Currently, no direct expenses are being passed on to the Pool. A traditional money market fund typically charges between twenty-five (.0025) and fifty (.0050) BPS plus expenses.

### **Withdrawals**

Funds residing in the Pool are available to be spent at any time. OFM requests that it be notified as early as possible of any disbursements from the statewide accounting system that are unusually large for an agency.

### **Dividends and Distributions**

The Pool declares dividends as of the conclusion of each business day and pays them to shareholders on the last business day of each month. Earnings for Saturdays, Sundays, and holidays are declared on the previous business day.

For the purpose of calculating dividends, the Pool's net income consists of interest earned, plus any discount ratably amortized to the date of maturity, plus or minus all realized gains and losses on the sale of securities prior to maturity, less ratably amortization of any premium and all accrued expenses, including the fees payable to the OFM.

Current yield information for the Pool may, from time to time, be quoted in reports, and literature published by the Pool. Historic yield information will be available on the SIC's website at <http://finance.ky.gov/services/ofm/Pages/StateInvestmentCommission.aspx>.

The annual yield of the Pool may also be quoted. The annual yield reflects the value of compounding and represents the annualization of the monthly distribution yield with all dividends reinvested. The effective annual yield is computed by adding 1 to the monthly distribution yield for a monthly calendar period, raising the sum to the power of 12, and then subtracting 1 from the result.

### **Balance Inquiries**

OFM is not responsible for delays or errors in posting of account balances in the statewide accounting system.

All inquiries regarding should be directed to Office of Statewide Accounting Services, 702 Capitol Avenue, Room 484, Frankfort, Kentucky 40601.

### **Safekeeping**

Investments are held by the Commonwealth's custodial bank, currently State Street Bank of Boston, Massachusetts. The Commonwealth also has a triparty custodial account with the Bank of New York/Mellon to facilitate the execution of tri-party repos.

### **Risk Management**

**The SIC expressly prohibits the use of leverage or the posting of margin.**

OFM utilizes industry standard portfolio accounting and risk management software, including marking the portfolio to market daily to minimize basis risk. Counterparty risk is managed by established credit review by OFM and approval by the SIC approved broker/dealers and other counterparties.

### **Securities Lending**

The Pool may lend securities held in the portfolio to broker/dealers approved by the SIC. Income derived from securities lending will accrue to the benefit of the Pool. Currently, the Securities Lending Program is operated on an agency basis with Deutsche Bank. The state's portfolio of treasuries, agencies and corporate bonds is made available to Deutsche Bank. Earnings are split 85% to the Commonwealth and 15% to Deutsche Bank.

Previously, and perhaps again in the future, the state has the right to enter into a principal agreement for its Securities Lending Program. A principal agreement would guarantee a stated payout for all of the state's treasuries, agencies and corporate bonds. This contract is bid every two (2) years with the best arrangement, whether agent or principal, determined at that time.

### **Prohibited Transactions**

The SIC prohibits:

- The use of leverage;
- The posting of margin such as used in the purchase or sale of futures contracts; and
- The purchase of interest only, principal only, inverse floating rate or other similar types of securities deemed inappropriate for governmental use.

### **Approved Brokers / Dealers**

Broker/dealers are approved annually by the State Investment Commission subject to certain set forth in Section 10 of 200 KAR 14:011 Qualified Investment. Broker/dealers are generally restricted to primary dealers of the Federal Reserve Bank of New York, registered broker/dealers with a physical presence in Kentucky or certain other broker/dealers meeting credit constraints and approval of the SIC. Additionally, transactions may be executed directly with the issuer of securities or on approved electronic exchanges. Almost all transactions shall be executed on a delivery versus payment basis to limit transaction risk from the counter party.

**Brokerage Transactions** - When selecting brokers and dealers to facilitate the purchase and sale of portfolio instruments, OFM looks for prompt execution of the order at the most favorable price.



VI.  
**LIMITED TERM POOL INFORMATION STATEMENT.**

THIS INFORMATION STATEMENT PROVIDES DETAILED INFORMATION ABOUT THE INVESTMENT OBJECTIVES, ORGANIZATION, STRUCTURE AND OPERATIONS OF THE LIMITED TERM POOL (THE “POOL”) AND ITS INVESTMENT OPPORTUNITIES. PROSPECTIVE INVESTORS SHOULD READ IT CAREFULLY BEFORE INVESTING AND RETAIN IT FOR FUTURE REFERENCE.

This Information Statement shall apply to only the Limited Term Pool (the Pool).

A. **Investment Objectives.**

The preservation of principal is the prime directive of the Limited Term pool. This pool will be managed to maintain a stable \$1.00 net asset value (NAV). To this aim, the Pool intends to operate following guidelines similar to those governing money market mutual funds. However, there is no assurance that the Pool will be able to maintain a stable NAV of \$1.00.

The performance of the pool shall be benchmarked to the Standard & Poors Local Government Investment Pool index. The return comparisons shall be made gross of fees to focus purely on management performance. The pool shall be managed on a total return basis to maximize excess return after the objectives of preservation of principal and maintenance of adequate liquidity have been met.

B. **Permitted Investments.**

The Pool is specifically designed to meet the needs of the SIC and the Commonwealth. Accordingly, its portfolios will invest solely in permitted investments as defined in KRS 42.500 and as further limited by 200 KAR Chapter 14 (Permitted Investments). Such Permitted Investments include the following:

- U.S. Treasury, agency, and GSE securities;
- U.S. dollar denominated corporate and Yankee securities issued by foreign and domestic issuers, rated in one (1) of the three (3) highest categories by a NRSRO;
- Money market securities, including:
  - CP rated prime at the time of purchase and maturing not more than 270 days after the date of purchase;
  - CD maturity not more than 270 days after the date of purchase; and
  - BA issued by banks having the highest short-term rating by an NRSRO.

- REPOs collateralized at least 102% (marked to market daily) with U.S. Treasury, agency or GSE agencies, or agency mortgage backed obligations. The maximum maturity is 365 days and executed with a counter-party approved by the Commission. Such transactions shall be executed with Commonwealth tri-party custodian banks or delivery versus payment at the Commonwealth's custodial bank.
- Mutual funds in which the underlying holdings of the fund are in securities in which the Pool could invest directly; and
- Any other investments presently permitted by applicable statutes or permitted in the future by reason of the enactment or amendment of applicable statutes.

C. Limits on Investment Securities.

1. Mortgage-backed securities are not allowed in this pool.
2. Asset-backed securities are not allowed in this pool.
3. U.S. dollar denominated corporate, Yankee and sovereign securities issued by foreign and domestic issuers shall not exceed 35% of an individual pool or \$25 million per issuer within an individual pool, inclusive of CP, BAs, and CDs unless these securities are guaranteed by the full faith and credit of the U.S. government.
4. No more than 10% of total pool assets shall be invested in a single mutual fund.
5. For purposes of meeting the minimum credit rating requirements herein, the lowest rating assigned by an Nationally Recognized Statistical Rating Organization (“NRSRO”) designated by the Commission on an annual basis.
6. The credit and diversification requirements documented herein shall apply at the time of purchase based on book value for the Limited Term Pool.
7. The credit and diversification requirements documented herein do not apply to inter pool borrowings.
8. The limits set forth in this section may be waived by unanimous vote of the SIC.

Any percentage limitation or rating requirement described under “Investments Objectives and Policies” will be applied **at the time of purchase**.

The Pool limits its investments to high quality instruments and the following policies are designed to maintain a stable \$1.00 share price, including maintaining a dollar-weighted average pool maturity of sixty (60) days or less. If the ratio of the Pool's market value divided by its book value is less than 0.995 or greater than 1.005, the OFM may sell Pool holdings or take other action to maintain the ratio between 0.995 and 1.005. However, there is no assurance that a NAV of \$1.00 per share can be maintained.

#### D. Operating Procedures.

The Limited Term Pool will be managed in a manner which meets most requirements of Section 2a.7 of the Investment Company Act of 1940 however this is not a 2a-7 like pool as described in GASB 31. Terms used in this section will have the definition prescribed in the Investment Company Act of 1940.

1. The Limited Term Pool will not purchase a security with a final maturity exceeding 365 days.
2. The weighted average maturity, adjusted for interest rate resets and demand features, shall not exceed sixty (60) days; and the weighted average life, adjusted for demand features only but not interest rate resets, shall not exceed one-hundred and twenty (120) days.
3. At least 10% of the Pool will be invested in cash, direct obligations of the U.S. government or securities that mature or are subject to a demand feature payable within one (1) business day, and at least 30% of the Pool will be invested in cash, direct obligations of the U.S. government, government agency discount notes maturing in sixty (60) days or less, or securities that mature or are subject to a demand feature payable within five (5) business days.
4. All securities purchased for the Pool must be rated by an NRSRO.
5. No more than 5% of the Pool will be invested in illiquid securities.
6. No more than 3% of the Pool will be invested in second tier securities and no more than 0.05% of the Pool will be invested in a second tier security issuer.
7. The NAV of Pool shares will be computed using the amortized cost method of valuing the Pool's investments.
8. The shadow NAV using the market value of Pool holdings will be computed no less than monthly and made public within sixty (60) days of the calculation date by posting to the SIC website at:  
<http://finance.ky.gov/services/ofm/Pages/StateInvestmentCommission.aspx>.
9. Stress testing of the Pool based on redemptions and changes in market value will be performed no less than quarterly and reported to the SIC.
10. Monthly portfolio listings will be published to a public website and will remain available for no less than six (6) months.

E. Accounting.

The assets in each individual pool are valued daily. The daily valuation marks each of the pool's securities to market daily, recognizing any gains or losses. However, all securities in the Limited Term pool have a remaining maturity at time of purchase of one year or less and meet the GASB Statement 31 definition of "money market investments". These securities shall be valued at amortized cost in compliance with paragraph 9 of GASB Statement 31. In effect, while the pool is marked to market, all of the assets of the pool are carried at amortized cost resulting in the pool actually be valued at amortized cost. The investment income of the pool is declared daily as income of each qualifying fund. Cash income is distributed monthly.

Income is earned only on balances held in accounts that have statutory authority to receive investment income. Any accounts with a negative balance will be considered to have borrowed funds from the pool at the investment yield earned for the days the account is negative. OFM must have access to the enabling legislation or statutory reference to distribute income. Income will only be posted to qualified accounts that have a balance in the eMARS system as kept by the Division of Accounts in the FAC. OFM is not responsible for delays or errors in posting of account balances on the eMARS system. All inquiries should be directed to: Office of Statewide Accounting Services, 702 Capitol Avenue, Room 484, Frankfort, Kentucky 40601.

F. Valuation.

The OFM will periodically monitor, as they deem appropriate and at such intervals as are reasonable in light of current market conditions, the relationship between the amortized cost value per share and a NAV per share based upon available indications of market value. The NAV per share of the Pool may be affected by general changes in interest rates that result in increases or decreases in the value of securities held by the Pool. The market value of securities will tend to vary inversely to changes in prevailing interest rates. If interest rates rise after a security is purchased, such a security, if sold, might be sold at a price less than its amortized cost. Similarly, if interest rates decline, such a security, if sold, might be sold at a price greater than its amortized cost. If a security is held to maturity, no loss or gain is normally realized as a result of these price fluctuations.

Withdrawals by Participants could require the sale of Pool securities prior to maturity. In the event that the difference between the amortized cost and market value per share exceeds 1/2 of 1%, OFM will consider what, if any, corrective action should be taken to minimize any material dilution or other unfair results arising from differences between the two. This action could include reducing the number of outstanding shares by having each Participant proportionately contribute shares to the Pool's capital, declaring a special capital distribution, selling Pool securities prior to maturity to reduce the average maturity or to realize capital gains or losses, or transferring Pool securities to a separate account.

By investing in the Pool, Participants are deemed to have agreed to make a contribution, if these circumstances arise through their account balances as reflected in the statewide accounting system.

## **Certain Risks of Investment in the Pool**

There are several risk factors that could hurt a Pool's performance, cause you to lose money, or cause a Pool's performance to trail that of other investments.

### **A. Commercial Paper (CP).**

The Pool may purchase CP, which qualifies as a Permitted Investment. CP is a debt instrument that is issued by a company and is secured only by the assets, if any, of that company. The creditworthiness of such an obligation relates only to the creditworthiness of the issuing company. Although the OFM uses the criteria established by the SIC when determining which companies' CP will be purchased, no assurance can be given that a company will not become insolvent before it repays said CP. In the event of such insolvency or in the event of any other default with respect to such CP, a claim will be filed by the Pool against the company, if appropriate. However, there is no assurance that the Pool will receive any recovery as a result of filing a claim.

### **B. Bankers' Acceptances (BA).**

BAs are credit instruments evidencing the obligation of a bank to pay a draft drawn on it by a customer. These instruments reflect the obligations both of the bank and of the drawer to pay the face amount of the instrument upon maturity. They are not subject to FDIC insurance, but rather their creditworthiness relates only to the creditworthiness of the issuing bank.

*An investment in the Pool is not insured or guaranteed by the FDIC or any other government agency. Although the Pool seeks to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in the Pool.*

### **Additional Policies**

**Calculating Net Asset Value (NAV).** The OFM calculates the Pool's NAV as of the conclusion of each business day. To calculate NAV, the Pool first subtracts its total liabilities from its total assets, and then divides the result by the number of outstanding shares. Liabilities include all accrued expenses and fees, including fees of the OFM, which are accrued daily.

For purposes of calculating NAV, securities are valued at cost, plus or minus any amortized discount or premium.

**How Purchase Prices are Determined.** The exact price for your shares will be determined based on the first NAV calculation after the deposit has been processed in the statewide accounting system. The NAV used will also determine the number of shares you receive.

**Information on Portfolio Holdings.** The Pool discloses its holdings online each month.

## VI.

### **INTERMEDIATE TERM POOL INFORMATION STATEMENT.**

THIS INFORMATION STATEMENT PROVIDES DETAILED INFORMATION ABOUT THE INVESTMENT OBJECTIVES, ORGANIZATION, STRUCTURE AND OPERATIONS OF THE INTERMEDIATE TERM POOL (THE “POOL”) AND ITS INVESTMENT OPPORTUNITIES. PROSPECTIVE INVESTORS SHOULD READ IT CAREFULLY BEFORE INVESTING AND RETAIN IT FOR FUTURE REFERENCE.

This Information Statement shall apply to only the Intermediate Term Pool (the Pool).

#### **A. Investment Objectives.**

The Intermediate Pool will accept mark-to-market risk. The participants in this pool generally have a longer time horizon than participants in the Limited Term Pool. This longer time horizon allows the participants to accept some volatility in the market value of the investments in exchange for the higher return which should be earned compared to the Limited Term Pool.

The performance of the pool shall be benchmarked to a blended index composed of 70% of the BofA Merrill Lynch 1-3 Year US Treasury & Agency Index, 15% of the BofA Merrill Lynch 0-3 Year US Mortgage Backed Securities Index, and 15% of the BofA Merrill Lynch 0-3 Month US Treasury Bill Index. The return comparisons shall be made gross of fees to focus purely on management performance. The pool shall be managed on a total return basis to maximize excess return after the objectives of preservation of principal and maintenance of adequate liquidity have been met.

#### **B. Permitted Investments.**

The Pool is specifically designed to meet the needs of the SIC and the Commonwealth. Accordingly, its portfolios will invest solely in permitted investments as defined in KRS 42.500 and as further limited by 200 KAR Chapter 14 (Permitted Investments). Such Permitted Investments include the following:

- U.S. Treasury, agency, and GSE securities including mortgage-backed securities;
- Certificates of deposit issued by chartered by Kentucky or the United States;
- Money market securities, including:
  - CP rated in the highest short term category by a Nationally Recognized Statistical Rating Organization (NRSRO); and
  - BA issued by banks having the highest short-term rating by an NRSRO.
- Municipal securities rated in one of the 3 highest long term categories by an NRSRO;

- US dollar denominated corporate, Yankee and Eurodollar securities rated in one of the three highest categories by an NRSRO;
- Asset-backed securities rated in the highest category by an NRSRO;
- REPOs collateralized at least 102% (marked to market daily) with U.S. Treasury, agency or GSE agencies, or agency mortgage backed obligations;
- State and local delinquent property tax claims;
- Mutual funds in which the underlying holdings of the fund are in securities in which the Pool could invest directly; and
- Any other investments presently permitted by applicable statutes or permitted in the future by reason of the enactment or amendment of applicable statutes.

C. Limits on Investment Securities.

1. Mortgage-backed securities are limited to 25% of total pool assets.
2. Asset-backed securities are limited to 20% of total pool assets.
3. U.S. dollar denominated corporate, Yankee and sovereign securities issued by foreign and domestic issuers shall not exceed 35% of an individual pool or \$25 million per issuer within an individual pool, inclusive of CP, BAs, and CDs unless these securities are guaranteed by the full faith and credit of the U.S. government.
4. No more than 10% of total pool assets shall be invested in a single mutual fund.
5. For purposes of meeting the minimum credit rating requirements herein, the lowest rating assigned by an Nationally Recognized Statistical Rating Organization (“NRSRO”) designated by the Commission on an annual basis.
6. The credit and diversification requirements documented herein shall apply at the time of purchase based on the market value for the Intermediate Term Pool.
7. The limits set forth in this section may be waived by unanimous vote of the SIC.

Any percentage limitation or rating requirement described under “Investments Objectives and Policies” will be applied **at the time of purchase**.



D. Operating Procedures.

The Intermediate Term Pool will be managed in a manner similar to the standard approaches for managing a short fixed income mutual fund. The duration shall be limited to a maximum of 3 years but shall normally remain between 1 and 2 years.

E. Accounting.

The assets in each individual pool are valued daily. The daily valuation marks each of the pool's securities to market daily, recognizing any gains or losses. The investment income of the pool is declared daily as income of each qualifying fund. Cash income is distributed monthly.

Income is earned only on balances held in accounts that have statutory authority to receive investment income. Any accounts with a negative balance will be considered to have borrowed funds from the pool at the same rate as is earned on overnight investments for the days the account is negative. OFM must have access to the enabling legislation or statutory reference to distribute income. Income will only be posted to qualified accounts that have a balance in the eMARS system as kept by the Division of Accounts in the FAC. OFM is not responsible for delays or errors in posting of account balances on the eMARS system. All inquiries should be directed to: Office of Statewide Accounting Services, 702 Capitol Avenue, Room 484, Frankfort, Kentucky 40601.

F. Valuation.

The Intermediate Pool will be marked to market daily and all gains and losses recognized daily. As interest rates rise, the value of the securities in the pool will decline. This loss in value is offset by the interest earned on the individual securities. However, the loss in value will at time outweigh the interest earnings. There is no guarantee that a participant will be able to withdraw all funds placed in the pool if prices have moved in a detrimental fashion. Participants who leave funds in the pool should over time see the accumulated interest outweigh any adverse price movements.

## Appendix A Abbreviations

Acronyms	Meaning
ABS	Asset-Backed Securities
BA	Banker's Acceptance
BPS	Basis Point
CD	Certificates of Deposit
CDARS	Certificate of Deposit Account Registry Service
CFR	Code of Federal Regulation
CMO	Collateralized Mortgage Obligation
CP	Commercial Paper
CUSIP	Committee on Uniform Security Identification Procedures
EXIM	Export-Import Bank of the United States
FAC	Finance and Administration Cabinet
FDIC	Federal Deposit Insurance Corporation
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation (aka Freddie Mac)
FmHA	Farmers Home Administration
FNMA	Federal National Mortgage Association (aka Fannie Mae)
GASB	Governmental Accounting Standards Board
GNMA	Government National Mortgage Association (aka Ginnie Mae)
GSE	Government-Sponsored Enterprise
ICS	Insured Cash Sweep
KAR	Kentucky Administrative Regulation
KRS	Kentucky Revised Statute
MBS	Mortgage-Backed Security
NAV	Net Asset Value
NRSRO	Nationally Recognized Statistical Ratings Organization
OFM	Office of Financial Management
REMIC	Real Estate Mortgage Investment Conduit
REPO	Repurchase Agreement
SEC	Securities Exchange Commission
SIC	State Investment Commission
TD	Time Deposits
TVA	Tennessee Valley Authority
USC	United States Code

## **Appendix B**

### **Glossary of Terms**

#### **2a7-Like Pool –**

Means an external investment pool that is not registered with the Securities and Exchange Commission (SEC) as an investment company, but nevertheless has a policy that it will, and does, operate in a manner consistent with the SEC's Rule 2a7 of the Investment Company Act of 1940 (17 CFR §270.2a-7). Rule 2a7 currently allows SEC-registered mutual funds to use amortized cost rather than market value to report net assets to compute share prices if certain conditions are met. Starting in July of 2016, 2a7 pools that are not considered retail or governmental will need to switch to market value to report net assets. Those conditions include restrictions on the types of investments held, restrictions on the term-to-maturity of individual investments and the dollar-weighted average of the portfolio, requirements for portfolio diversification, requirements for divestiture considerations in the event of security downgrades and defaults, and required actions if the market value of the portfolio deviates from amortized cost by a specified amount.

#### **Accredited Investor –**

Shall mean—(i) a bank as defined in Section 3(a)(2) whether acting in its individual or fiduciary capacity; an insurance company as defined in Paragraph (13) of this Sub-Section; an investment company registered under the Investment Company Act of 1940 or a business development company as defined in Section 2(a)(48) of that Act; a Small Business Investment Company licensed by the Small Business Administration; or an employee benefit plan, including an individual retirement account, which is subject to the provisions of the Employee Retirement Income Security Act of 1974, if the investment decision is made by a plan fiduciary, as defined in Section 3(21) of such Act, which is either a bank, insurance company, or registered investment adviser; or (ii) any person who, on the basis of such factors as financial sophistication, net worth, knowledge, and experience in financial matters, or amount of assets under management qualifies as an accredited investor under rules and regulations which the SEC shall prescribe.

#### **Acquisition or Acquire –**

Means any purchase or subsequent rollover (but does not include the failure to exercise a demand feature).

#### **Amortized Cost Method of Valuation –**

Means the method of calculating an investment company's net asset value (NAV) whereby portfolio securities are valued at the fund's acquisition cost as adjusted for amortization of premium or accretion of discount rather than at their value based on current market factors. (See 17 CFR 270.2a-7(a) (2))

#### **Asset-Backed Securities (ABS) –**

Means assets that are composed of, or collateralized by, loans or receivables. Collateralization can consist of liens on real property, leases, or credit card debt.

#### **Bankers Acceptance (BA) –**

Means a short-term negotiable discount note drawn on and accepted by a bank or trust company, which is obligated to pay the face value amount at maturity.

**Basis Point (BPS) –**

A basis point is a unit that is equal to 1/100th of 1%, and is often used instead of percentages when discussing interest rates, rates of return, and other percentage-based performance metrics that can occur as fractions of a percent.

**Collateralized Fully –**

Means “collateralized fully” as defined in § 270.5b–3(c) (1) except that §270.5b–3(c) (1) (iv) (C) and (D) shall not apply. (See 17 CFR 270.5b-3(c) (1))

**Commercial Paper (CP) –**

Means an unsecured promissory obligation having a maturity of less than 270 days.

**Commission –**

Means the State Investment Commission (SIC).

**Conditional Demand Feature –**

Means a demand feature that is not an unconditional demand feature. A conditional demand feature is not a guarantee. (See 17 CFR 270.2a-7(a) (6))

**Conduit Security –**

Means a security issued by a municipal issuer involving an arrangement or agreement entered into, directly or indirectly, with a person other than a municipal issuer, which arrangement or agreement provides for or secures repayment of the security. A Conduit Security does not include a security that is: (i) Fully and unconditionally guaranteed by a Municipal Issuer; (ii) Payable from the general revenues of the Municipal Issuer or other Municipal Issuers (other than those revenues derived from an agreement or arrangement with a person who is not a Municipal Issuer that provides for or secures repayment of the security issued by the Municipal Issuer); (iii) Related to a project owned and operated by a Municipal Issuer; or (iv) Related to a facility leased to and under the control of an industrial or commercial enterprise that is part of a public project which, as a whole, is owned and under the control of a Municipal Issuer. (See 17 CFR 270.2a-7(a) (7))

**Control –**

Means “control” as defined in Section 2(a) (9) of the Act (15 USC 80a–2(a) (9)); or (ii) A sponsor of a special purpose entity with respect to an ABS. (See 15 USC 80a-2(a) (9))

**Daily Liquid Assets –**

Means: (i) Cash; (ii) Direct obligations of the US government; or (iii) Securities that will mature or are subject to a demand feature that is exercisable and payable within one (1) business day. (See 17 CFR 270.2a-7(a) (8))

**Dealer –**

Means any person who engages either for all or part of his/her time, directly or indirectly, as agent, broker or principal, in the business of offering, buying, selling or otherwise dealing or trading in securities issued by another person. (See Securities Act of 1933 Sec. 2(a) (12))

**Demand Feature –**

Means: (i) A feature permitting the holder of a security to sell the security at an exercise price equal to the approximate amortized cost of the security plus accrued interest, if any, at the time of exercise. A demand feature must be exercisable either: (A) At any time on no more than 30 calendar days' notice; or (B) At specified intervals not exceeding 397 calendar days and upon no more than 30 calendar days' notice; or (ii) A feature permitting the holder of an ABS unconditionally to receive principal and interest within 397 calendar days of making demand. (See 17 CFR 270.2a-7(a) (9))

**Demand Feature Issued by a Non-Controlled Person –**

Means a demand feature issued by: (i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the demand feature. (See 17 CFR 270.2a-7(a) (10))

**Designated NRSRO –**

Means any one (1) of the Nationally Recognized Statistical Rating Organizations, as that term is defined in Section 3(a)(62) of the Securities Exchange Act of 1934 (15 USC 78c(a)(62)), that: (i) The money market fund's board of directors: (A) Has designated as an NRSRO whose credit ratings with respect to any obligor or security or particular obligors or securities will be used by the fund to determine whether a security is an eligible security; and (B) Determines at least once each calendar year issues credit ratings that are sufficiently reliable for such use; (ii) Is not an "affiliated person," as defined in Section 2(a)(3)(C) of the Act (15 USC 80a-2(a)(3)(C)), of the issuer of, or any insurer or provider of credit support for, the security; and (iii) The fund discloses in its statement of additional information is a designated NRSRO, including any limitations with respect to the fund's use of such designation. (See 17 CFR 270.2a-7(a) (11))

**Eligible Financial Institution –**

Means: (a) A commercial bank, or savings and loan association: 1. Chartered to do business in Kentucky by the Commonwealth of Kentucky, or by an agency of the US government; and 2. That maintains an office in Kentucky; or (b) A broker/dealer approved pursuant to the provisions of Section 10 of 200 KAR 14:011.

**Eligible Security (Relative to 2a7 and 2a7-Like Pools) –**

Means: (i) A rated security with a remaining maturity of 397 calendar days or less that has received a rating from the requisite NRSROs in one (1) of the two (2) highest short-term rating categories (within which there may be sub-categories or gradations indicating relative standing); or (ii) An unrated security that is of comparable quality to a security meeting the requirements for a rated security in Paragraph (a)(12)(i) of this Section, as determined by the money market fund's board of directors; provided, however, that: A security that at the time of issuance had a remaining maturity of more than 397 calendar days, but that has a remaining maturity of 397 calendar days or less and that is an unrated security is not an eligible security, if the security has received a long-term rating from any designated NRSRO that is not within the designated NRSRO's three (3) highest long-term ratings categories (within which there may be sub-categories or gradations indicating relative standing), unless the security has received a long-term rating from the requisite NRSROs in one (1) of the three (3) highest rating categories. (iii) In addition, in the case of a security that is subject to a demand feature or guarantee: (A) The guarantee has received a rating from a designated NRSRO

or the guarantee is issued by a guarantor that has received a rating from a designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security to the guarantee, unless: (1) The guarantee is issued by a person that, directly or indirectly, controls, is controlled by or is under common control with the issuer of the security subject to the guarantee (other than a sponsor of a special purpose entity with respect to an ABS); (2) The security subject to the guarantee is a REPO that is collateralized fully; or (3) The guarantee is itself a government security; and (B) The issuer of the demand feature or guarantee, or another institution, has undertaken promptly to notify the holder of the security in the event the demand feature or guarantee is substituted with another demand feature or guarantee (if such substitution is permissible under the terms of the demand feature or guarantee). (See 17 CFR 270.2a-7(a) (12))

#### Event of Insolvency –

Means, with respect to a person: (i) An admission of insolvency, the application by the person for the appointment of a trustee, receiver, rehabilitator, or similar officer for all or substantially all of its assets, a general assignment for the benefit of creditors, the filing by the person of a voluntary petition in bankruptcy or application for reorganization or an arrangement with creditors; or (ii) The institution of similar proceedings by another person, which proceedings are not contested by the person; or (iii) The institution of similar proceedings by a government agency responsible for regulating the activities of the person, whether or not contested by the person. (See 17 CFR 270.2a-7(a) (13))

#### First Tier Security –

Means any eligible security that: (i) Is a rated security that has received a short-term rating from the requisite NRSROs in the highest short-term rating category for debt obligations (within which there may be sub-categories or gradations indicating relative standing); (ii) Is an unrated security that is of comparable quality to a security meeting the requirements for a rated security in Paragraph (a)(14)(i) of this Section, as determined by the fund's board of directors; (iii) Is a security issued by a registered investment company that is a money market fund; or (iv) Is a government security. (See 17 CFR 270.2a-7(a) (14))

#### Floating Rate Security –

Means a security the terms of which provide for the adjustment of its interest rate whenever a specified interest rate changes and that, at any time until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost. (See 17 CFR 270.2a-7(a) (15))

#### Government Security –

Means any security issued or guaranteed as to principal or interest by the US, or by a person controlled or supervised by and acting as an instrumentality of the Government of the US pursuant to authority granted by the Congress of the US; or any CD for any of the foregoing. (See Investment Company Act of 1940 Sec. 2(a) (16) or 17 CFR 270.2a-7(a) (17))

#### Guarantee –

Means: (i) An unconditional obligation of a person other than the issuer of the security to undertake to pay, upon presentment by the holder of the guarantee (if required), the principal amount of the underlying security plus accrued interest when due or upon default, or, in the case of an unconditional demand feature, an obligation that entitles the holder to receive upon the later of exercise or the settlement of the transaction the approximate amortized cost of the underlying security or securities, plus accrued interest, if any. A guarantee includes a letter of credit, financial guaranty (bond) insurance, and an unconditional demand feature (other than an unconditional demand feature provided by the issuer of the security). (ii) The sponsor of a special purpose entity with respect to an ABS shall be deemed to have provided a guarantee with respect to the entire principal amount of the ABS for purposes of this Section, except Paragraphs (a)(12)(iii) (definition of eligible security), (d)(2)(iii) (credit substitution), (d)(3)(iv)(A) (fractional guarantees) and (e) (guarantees not relied on) of this Section, unless the money market fund's board of directors has determined that the fund is not relying on the sponsor's financial strength or its ability or willingness to provide liquidity, credit or other support to determine the quality (pursuant to Paragraph (d)(2) of this Section) or liquidity (pursuant to Paragraph (d)(4) of this Section) of the ABS, and maintains a record of this determination (pursuant to Paragraphs (g)(7) and (h)(6) of this Section). (See 17 CFR 270.2a-7(a) (18))

#### Guarantee Issued by a Non-Controlled Person –

Means a guarantee issued by: (i) A person that, directly or indirectly, does not control, and is not controlled by or under common control with the issuer of the security subject to the guarantee. (See 17 CFR 270.2a-7(a) (19))

#### Illiquid Security –

Means a security that cannot be sold or disposed of in the ordinary course of business within seven (7) calendar days at approximately the value ascribed to it by the fund. (See 17 CFR 270.2a-7(a) (20))

#### Issuer –

Means every person who issues or proposes to issue any security; except that with respect to CDs, voting-trust certificates, or collateral-trust certificates, or with respect to certificates of interest or shares in an unincorporated investment trust not having a board of directors (or persons performing similar functions) or of the fixed, restricted management, or unit type, the term “issuer” means the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued; except that in the case of an unincorporated association, which provides by its articles for limited liability of any or all of its members, or in the case of a trust, committee, or other legal entity, the trustees or members thereof shall not be individually liable as issuers of any security issued by the association, trust, committee, or other legal entity; except that with respect to equipment-trust certificates or like securities, the term “issuer” means the person by whom the equipment or property is or is to be used; and except that with respect to fractional undivided interests in oil, gas, or other mineral rights, the term “issuer” means the owner of any such right or of any interest in such right (whether whole or fractional) who creates fractional interests therein for the purpose of public offering. (See Securities Act of 1933 Sec. 2(a) (4))

**Money Market Investment –**

Means a short-term, highly liquid debt instrument, including CP, BA and US Treasury and agency obligations. ABS, derivatives and structured notes are not included in this term.

**Municipal Issuer –**

Means a State or territory of the US (including the District of Columbia), or any political subdivision or public instrumentality of a State or territory of the US. (See 17 CFR 270.2a-7(a) (7))

**NRSRO –**

Means "Nationally Recognized Statistical Ratings Organization", which is a credit rating agency that is registered with the SEC, and which provides its opinion on the creditworthiness of an entity and the financial obligations issued by that entity.

**Office –**

Means the Office of Financial Management (OFM).

**Prospectus –**

Means any prospectus, notice, circular, advertisement, letter or communication, written or by radio or television, which offers any security for sale or confirms the sale of any security; except that (a) a communication sent or given after the effective date of the registration statement (other than a prospectus permitted under Sub-Section (b) of Section 10) shall not be deemed a prospectus, if it is proved that prior to or at the same time with such communication a written prospectus meeting the requirements of Sub-Section (a) of Section 10 at the time of such communication was sent or given to the person to whom the communication was made, and (b) a notice, circular, advertisement, letter, or communication in respect of a security shall not be deemed to be a prospectus, if it states from whom a written prospectus meeting the requirements of Section 10 may be obtained and, in addition, does no more than identify the security, state the price thereof, state by whom orders will be executed, and contain such other information as the SEC by rules or regulations deemed necessary or appropriate in the public interest and for the protection of investors, and subject to such terms and conditions as may be prescribed therein, may permit. (See Securities Act of 1933 Sec. 2(a) (10))

**Purchase or Sale of a Security-Based Swap –**

Shall be deemed to mean the execution, termination (prior to its scheduled maturity date), assignment, exchange or similar transfer or conveyance of, or extinguishing of rights or obligations under, a security-based swap, as the context may require. (See Securities Act of 1933 Sec. 2(a) (18))

**Qualifying Assets –**

Means financial assets, either fixed or revolving, that by their terms convert into cash within a finite time period, plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders. (See 17 CFR 270.2a-7(a) (3))



**Rated Security –**

Means a security that meets the requirements of Paragraphs (a)(22)(i) or (ii) of this Section, in each case subject to Paragraph (a)(22)(iii) of this Section: (i) The security has received a short-term rating from a designated NRSRO, or has been issued by an issuer that has received a short-term rating from a designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the security; or (ii) The security is subject to a guarantee that has received a short-term rating from a designated NRSRO, or a guarantee issued by a guarantor that has received a short-term rating from a designated NRSRO with respect to a class of debt obligations (or any debt obligation within that class) that is comparable in priority and security with the guarantee; but (iii) A security is not a rated security if it is subject to an external credit support agreement (including an arrangement by which the security has become a refunded security) that was not in effect when the security was assigned its rating, unless the security has received a short-term rating reflecting the existence of the credit support agreement as provided in Paragraph (a)(22)(i) of this Section, or the credit support agreement with respect to the security has received a short-term rating as provided in Paragraph (a)(22)(ii) of this Section. (See 17 CFR 270.2a-7(a) (22))

**Repurchase Agreement (REPO) –**

Means an actual, conditional purchase or sale of securities of the US Treasury, an agency, instrumentality, or corporation of the US, or another security authorized for investment pursuant to KRS 42.500(9)(a) or (b), with an agreement to resell or repurchase the securities to their original owner on a specific date in the future.

**Retail Money Market Fund –**

Means a money market fund that has policies and procedures reasonably designed to limit all beneficial owners of the fund to natural persons. (See 17 CFR 270.2a-7(a) (25))

**Second Tier Security –**

Means any eligible security that is not a first tier security. (See 17 CFR 270.2a-7(a) (26))

**Security –**

Means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization certificate or subscription, transferable share, investment contract, voting-trust certificate, CD for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, CD, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security”, or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing. (See Securities Act of 1933 Sec. 2(a) (1))

**Single State Fund –**

Means a tax exempt fund that holds itself out as seeking to maximize the amount of its distributed income that is exempt from the income taxes or other taxes on investments of a particular state and, where applicable, subdivisions thereof. (See 17 CFR 270.2a-7(a) (27))

**Special Purpose Entity –**

Means a trust, corporation, partnership or other entity organized for the sole purpose of issuing securities that entitle their holders to receive payments that depend primarily on the cash flow from Qualifying Assets, but does not include a registered investment company. (See 17 CFR 270.2a-7(a) (3))

**Tax Exempt Fund –**

Means any money market fund that holds itself out as distributing income exempt from regular federal income tax. (See 17 CFR 270.2a-7(a) (28))

**Total Assets –**

Means, with respect to a money market fund using the Amortized Cost Method, the total amortized cost of its assets and, with respect to any other money market fund, means the total value of the money market fund's assets, as defined in Section 2(a)(41) of the Act (15 USC 80a-2(a)(41)) and the rules thereunder. (See 17 CFR 270.2a-7(a) (29))

**Unconditional Demand Feature –**

Means a demand feature that by its terms would be readily exercisable in the event of a default in payment of principal or interest on the underlying security or securities. (See 17 CFR 270.2a-7(a) (30))

**Underwriter –**

Means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this Paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. (See Securities Act of 1933 Sec. 2(a) (11))

**United States (US) Dollar-Denominated –**

Means, with reference to a security, that all principal and interest payments on such security are payable to security holders in US dollars under all circumstances and that the interest rate of, the principal amount to be repaid, and the timing of payments related to such security do not vary or float with the value of a foreign currency, the rate of interest payable on foreign currency borrowings, or with any other interest rate or index expressed in a currency other than US dollars. (See 17 CFR 270.2a-7(a) (31))

**Unrated Security –**

Means a security that is not a rated security by an NRSRO. (See 17 CFR 270.2a-7(a) (32))

**Variable Rate Security –**

Means a security the terms of which provide for the adjustment of its interest rate on set dates (such as the last day of a month or calendar quarter) and that, upon each adjustment until the final maturity of the instrument or the period remaining until the principal amount can be recovered through demand, can reasonably be expected to have a market value that approximates its amortized cost. (See 17 CFR 270.2a-7(a) (33))

**Weekly Liquid Assets –**

Means: (i) Cash; (ii) Direct obligations of the US government; (iii) Government securities that are issued by a person controlled or supervised by and acting as an instrumentality of the government of the US pursuant to authority granted by the Congress of the US that: (A) Are issued at a discount to the principal amount to be repaid at maturity without provision for the payment of interest; and (B) Have a remaining maturity date of 60 days or less. (iv) Securities that will mature, as determined without reference to the exceptions in Paragraph (i) of this Section regarding interest rate readjustments, or are subject to a demand feature that is exercisable and payable, within five (5) business days; or (v) Amounts receivable and due unconditionally within five (5) business days on pending sales of portfolio securities. (See 17 CFR 270.2a-7(a) (34))

## Appendix C

### Investment Matrix

INVESTMENT MATRIX					
Permitted Investments (See <a href="#">KRS 42.500</a> )	Examples	NRSRO Category	Aggregate Total Not To Exceed	Individual Total	Maturity Restrictions
US Denominated Corporate, Yankee and Eurodollar Securities		<a href="#">1 of 3 Highest Long-Term</a>		<a href="#">\$25m per Pool</a>	<a href="#">5 Years</a>
Money Market Securities (See <a href="#">200 KAR 14:091</a> ):	a) Collateralized or Uncollateralized Certificates of Deposit (CDs)	<ul style="list-style-type: none"> <li>Collateralized CDs: <a href="#">1 of 3 Highest Ratings</a></li> <li>Uncollateralized negotiable CDs: <a href="#">1 of 2 Highest Ratings</a></li> <li>Implies the long term ratings</li> </ul>		<a href="#">\$25m per Pool</a>	<a href="#">270 Days</a>
	b) Bankers' Acceptances (BA)	<a href="#">Highest Short-Term</a>		<a href="#">\$25m per Pool</a>	<a href="#">180 Days</a>
	c) Commercial Paper (CP)	<a href="#">Highest Short-Term</a>		<a href="#">\$25m per Pool</a>	<a href="#">&lt; 270 Days</a>
US Dollar Denominated Sovereign Debt		<a href="#">1 of 3 Highest Ratings – Implies Long Term Rating</a>	<a href="#">5% of Individual Pool</a>	<a href="#">\$25m per Pool</a>	<a href="#">5 Years</a>
Corporate/Yankee/CP/BA/CDs/US Dollar Denominated Sovereign Debt			<a href="#">35% of each pool</a>	<a href="#">\$25m per Pool</a>	
Asset Back Securities (ABS)		<a href="#">Highest</a>	<a href="#">20% of Total Pool Assets</a>	No Limit	<a href="#">4 Year Average Life</a>
Government-Sponsored Entity (GSE)	a) Federal Home Loan Mortgage Corporation (FHLMC - Freddie Mac); Federal Farm Credit Banks (Bank for Cooperatives, Federal Intermediate Credit Banks and Federal Land Banks); Federal Home Loan Banks (FHLB); Federal National Mortgage Association (FNMA - Fannie Mae); Tennessee Valley Authority (TVA) obligations	N/A	100% of Total Pool Assets	No Limit	< 7 Years for non-mortgage related securities

INVESTMENT MATRIX					
Permitted Investments (See <a href="#">KRS 42.500</a> )	Examples	NRSRO Category	Aggregate Total Not To Exceed	Individual Total	Maturity Restrictions
	b) US Government Corporations: Export-Import Bank of US (EXIM), Farmers Home Administration (FmHA - terminated in 2006); Government National Mortgage Corporation (GNMA - Ginnie Mae); and Merchant Marine bonds	N/A	100% of Total Pool Assets	No Limit	< 7 Years for non-mortgage related securities
<b>Mortgage Pass-Through Securities/Real Estate Mortgage Investment Conduit Obligations (REMIC also known as CMO)</b>	FNMA, FHLMC and GNMA pass-throughs or CMOs and non-GSE backed REMICs	Highest Long-Term for non-GSE backed REMICs	<a href="#">25% of Total Pool Assets</a>	No Limit	<a href="#">&lt; 4 Year Average Life at Bloomberg Consensus Prepayment Expectations at time of purchase or &lt;6 years while held in portfolio</a>
<b>Municipal Obligations</b>	State or Local Government Securities (*Shall be waived for obligations issued by the Commonwealth of KY or any entity within the Commonwealth of KY)	<a href="#">1 of 3 Highest Long-Term</a>	100% of Total Pool Assets	<a href="#">\$25m per Name</a>	<a href="#">5 Years</a>
<b>Mutual Funds</b>	The underlying holdings of the fund are in securities in which the Pool could invest directly. (See <a href="#">200 KAR 14:011(6) (10)</a> ).	<a href="#">Highest</a>	100% of Total Pool Assets	Individual fund shall not exceed <a href="#">10% of Total Pool Assets</a>	N/A
<b>Repurchase Agreements (REPO)</b> (See <a href="#">200 KAR 14:081</a> )	Investment securities authorized for investment pursuant to <a href="#">KRS 42.500(9) (a) and (b)</a> shall be considered eligible securities for REPOs. (See <a href="#">200 KAR 14:081(4)</a> )	N/A	100% of Total Pool Assets	No Limit	<a href="#">1 Year Except for Country Bank</a>
<b>US Treasury Obligations</b>		N/A	100% of Total Pool Assets	No Limit	<a href="#">&lt; 7 Years</a>

## **Appendix D**

### **List of Restrictions**

#### **STATUTORY REQUIREMENTS**

State Investment Commission (SIC) must meet at least quarterly. KRS 42.500(3)  
SIC is responsible for investing excess cash in the State Treasury. (i.e. KRS 42.500(9) & (13)  
money must pass through the depository bank into the investment  
portfolio to be under the SIC purview).

Mutual funds must be registered with the SEC, at least 5 years old, be KRS 42.500(9)(i)  
rated in the highest category, and may only invest in securities which are  
allowed as direct investments.

#### **REGULATORY REQUIREMENTS**

##### **Qualified Investments**

Securities lending is an acceptable activity. There are no further 200 KAR 14:011(3)(1)(a)  
restrictions.

Income is calculated and allocated daily on an accrual basis. 200 KAR 14:011(4)

At the time of purchase the average life for MBS's and CMO's must be 200 KAR 14:011(6)(2) & (3)  
< 4 years using Bloomberg Consensus Prepayment projections. The  
particular security must be sold if the average life exceeds 6 years at  
Bloomberg Consensus Prepayment projects. (The projections are  
available on the YT screen on Bloomberg.)

Repurchase agreements must be collateralized with treasuries, agencies 200 KAR 14:011(6)(8)  
or agency MBSs or CMOs with at least 2% over-collateralization.

When checking the credit rating for compliance purposes, the minimum 200 KAR 14:011(6)(11)  
rating by an NRSRO shall be used. The SIC, at least annually, shall  
determine which NRSRO's shall be used.

The credit and diversification requirements documented in 200 KAR 200 KAR 14:011(7)(6)  
14:011 shall apply at the time of purchase based on book value for the  
Limited Term Pool and market value for other pools.

The limits set forth in 200 KAR 14:011 Section 7 may be waived by 200 KAR 14:011(7)(7)  
unanimous vote of the SIC, if a situation arises which could damage the  
state's credit.

**The Limited Term Pool shall meet the following requirements:**

Maximum maturity of any security is 365 days.	200 KAR 14:011(9)(1)(a)
The Weighted Average Maturity shall be < 60 days.	200 KAR 14:011(9)(1)(b)
The Weighted Average Life shall be < 120 days.	200 KAR 14:011(9)(1)(b)
At least 10% of the portfolio shall be invested in securities that mature or have a demand feature within 1 business day or be a T-bill.	200 KAR 14:011(9)(1)(c)(1)
At least 30% of the portfolio shall be in cash, T-bill, a discount note under 60 day maturity or shall mature in < 5 business days.	200 KAR 14:011(9)(1)(c)(2)
All securities shall be rated by an NRSRO.	200 KAR 14:011(9)(1)(d)
The value of the pool will be amortized book value, not market value.	200 KAR 14:011(9)(1)(g)
The shadow net asset value of pool shares using the market value of the pool shall be calculated at least monthly.	200 KAR 14:011(9)(1)(h)
A stress test shall be conducted at least quarterly and reported to the SIC.	200 KAR 14:011(9)(1)(i)
A listing of portfolio holdings shall be published monthly to a public website.	200 KAR 14:011(9)(1)(j)
The Intermediate Pool shall have a duration of < 3 years.	200 KAR 14:011(9)(2)(c)
An updated broker-dealer list shall be approved annually (June) with members meeting certain criteria as defined in 200 KAR 14:011(10).	200 KAR 14:011(10)
Trades shall not be executed with broker-dealers not on the approved list except the issuers of a particular security. For example CP can be purchased directly from the issuer.	200 KAR 14:011(10)(7)

**Repurchase Agreement**

Except as provided by <a href="#">KRS 41.610</a> , the Commission shall not invest public funds in a repurchase agreement with a yield less than could be received on a directly purchased US Treasury security of comparable maturity.	200 KAR 14:081(2)
Only treasuries, agencies and agency MBS are acceptable collateral for repurchase agreements.	200 KAR 14:081(4)

Minimum over-collateralization for repurchase agreements is 2%. A higher over-collateralization level may be negotiated.	200 KAR 14:081(5)(1)
The Commission shall demand additional securities to be delivered immediately, if market conditions cause the value of the securities purchased to drop below 102% of the face value of the repurchase agreement.	200 KAR 14:081(5)(3)
KY Bank Repurchase Program: A bank may only be accepted into the Country Bank program if they meet the following criteria. This is a strict test for entering the program. These criteria also give the SIC the right, but not obligation, of removing a bank from the program if they fail to meet these criteria for 2 consecutive quarters.	200 KAR 14:081(8)(1) & (3)
Loan to deposit ratio of $\geq 70\%$	200 KAR 14:081(8)(1)(a)
Nonperforming loan to capital ratio of $\leq 25\%$	200 KAR 14:081(8)(1)(b)
Capital to assets ratio $\geq 8\%$ or regulatory requirements	200 KAR 14:081(8)(1)(c)
Return on assets ratio (annualized) $> 0.50\%$	200 KAR 14:081(8)(1)(d)
MBS collateral for KY Bank Repurchase Program must be collateralized at 105%.	200 KAR 14:081(8)(5)(b)

### **SIC POLICY STATEMENTS**

Trading limits are approved and updated periodically.	December 2014
A private placement security issued under SEC Rule 144a may not be purchased, but may be held. (It is possible but unlikely for a security to be registered at issuance but fail to maintain the registration.)	June 2014
If a security is downgraded below the level at which it may be purchased, OFM staff have the authority to hold it for no more than 90 days. The SIC can approve holding it beyond this time period. The credit criteria written into statute and regulation apply at the time of purchase only.	June 2004

### **OFM STAFF INTERNAL GUIDELINE**

There is a \$200 million maximum limit on repurchase agreements with a single entity or on money market mutual funds.	No time frame.
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## Appendix E Trading Limits

<u>Position / Security Type</u>	<u>Daily Limit</u>
Money Market Trader:	
US Treasury Notes, US Agency Notes and Money Market Securities	\$150,000,000
Portfolio Manager:	
US Treasury Notes, US Agency Notes and Money Market Securities	\$200,000,000
Corporate Bonds	\$50,000,000
Municipals	\$50,000,000
Mortgage Backed Securities	\$50,000,000
Asset Backed Securities	\$50,000,000

All of the above may purchase repurchase agreements and money market funds as limited by investment policy.

The above schedule limits individuals to purchase only the securities types listed under their title and limits the par amounts each day unless approved by an individual with a higher limit. The Executive Director or Controller can approve exceptions to any of the above limits.

Money Market Securities means Commercial Paper, Certificates of Deposit, Variable Rate Demand Notes, Agency Discount Notes and Treasury Bills

*Portfolio Managers:* Kim Bechtel and Brian Caldwell

*Money Market Trader:* Amber Lee and Daniel Auxier

## **Appendix F**

### **Statutory Authority**

#### **KENTUCKY ADMINISTRATIVE REGULATIONS:**

[200 KAR 14:011](#) Qualified Investments

[200 KAR 14:081](#) REPO

[200 KAR 14:091](#) Guidelines for money market instruments

#### **KENTUCKY REVISED STATUTES:**

[KRS 41.610](#) Participation in program -- Investment agreements -- Required terms and conditions

[KRS 42.0201](#) Office of the Controller

[KRS 42.400](#) OFM

[KRS 42.410](#) Duties of OFM -- Contents of state debt report

[KRS 42.500](#) SIC – Powers

[KRS 42.505](#) Authority of State Investment Commission

[KRS 42.525](#) Authority to promulgate administrative regulations